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SUBJECT: COSTA RICA'S TELECOM MONOPOLY PREPARES FOR CHANGE

REF: SAN JOSE 2041

11. SUMMARY. With CAFTA-DR ratification slowly moving forward, and telecom competition on the horizon, Costa Rica's telecom monopoly, ICE, (Instituto Costarricense de Electricidad) is making moves to modernize under new ICE President, Pedro Pablo Quiros. The new ICE leadership is clearly engaged in strategic preparation for the future, spurred to action by the specter of competition. For instance, ICE recently announced that it will invest US\$20M to install 8,000 new multi-use public pay phones and has started offering Wi-Max internet service in selected areas. ICE also recently began offering higher speeds of internet service at about half previous prices through its subsidiary internet service provider. Meanwhile, to counter union opposition to CAFTA-DR, Quiros is by-passing union leadership and meeting directly with rank and file members weekly to explain that with recently enacted executive decrees and pending legislation, ICE can effectively compete in an open market. END SUMMARY.

12. PHONE LINES: CAFTA-DR requires that Costa Rica open its telecom market to competition for wireless service, data transmission and internet services when the treaty enters into force. Breaking up part of the government telecom monopoly is arguably the most contentious step. ICE is one of the most popular public institutions in Costa Rica for delivering land lines to 65% of homes nationwide (at the reportedly low cost of US\$8 per month), and plans to expand coverage (via public phone) to the remaining (mostly low-income) 35% of households, which rely heavily on public phones. Currently 400 aging pay phones, many of which are broken, are installed in the metropolitan area which has a population of approximately two million people. These old pay phones are being replaced by 8,000 new public phones with modern technology that will cost about \$2,500 per phone and will be installed throughout the country. The new phones will have text messaging and e-mail capability and will accept tokens, a new generation of prepaid phone cards with computer chips, as well as the older prepaid "Viajera 199" card.

13. INTERNET: According to ICE, in 2003 only 0.6% of Costa Ricans had access to the internet. Now 22% of Costa Ricans have access, primarily via offices and internet cafes, although residential installations continue to increase. In the past several months ICE's internet subsidiary has announced the availability of faster internet speeds at about half previous prices, and recently the current monopoly provider began offering Wi-Max service in two upscale suburban neighborhoods. The new ICE leadership is clearly engaged in strategic preparation for the future, spurred to action by the specter of competition.

14. MOBILE SERVICE: ICE's president recently stated that 35% of Costa Ricans have mobile phones, up from 3.6% in 2000. ICE's wireless infrastructure is sorely taxed and although there are plenty of cell phones for sale in the local market, there are long waiting lists to activate service. An industry source says that the tortuous public contracting process is partly at fault. In December 2002 ICE issued public tenders for the purchase of 600,000 cell

phone line (GSM) infrastructure. Ericsson was the successful bidder at US\$130 million. By the time the contract was finally awarded -- nearly 28 months later -- the technology was already outdated and worth only about US\$65 million. ICE thus ended up paying a hefty premium for outdated technology as a result of such slow processing.

¶5. The same industry source says that additional cell phone infrastructure is badly needed. Because of the lengthy contracting process ICE will probably extend the Ericsson contract, purchasing more outdated technology, at an increasing premium as the market value of the old technology continues to decline. The industry source summed it up aptly: ICE's current contracting process is longer than product lifetime. It is one of the reasons the ICE President has on his list of needed reforms, "a more agile and efficient contracting process".

¶6. LEGISLATION AND DECREES: Some of the reforms requested by ICE President Quiros were included in an executive decree recently signed by President Arias. Others that require legislation are included in a bill known as the "Strengthening ICE Law". In that bill, in addition to improved contracting authority, ICE is asking for more autonomy, the capacity to make investments, and the ability to operate internationally and form strategic alliances. This strengthening legislation is an important bargaining chip being used to convince the politically strong ICE union to accept breaking its monopoly in the wireless and data segments of the market.

COMMENT

¶7. LEADERSHIP MATTERS: ICE President Quiros has proven to be an adept choice by President Arias to lead the public telecom agency in a time of change. Arias's first selection to head ICE lasted only four months. Quiros's previous ICE and international work experience lend him credibility. He is engaged in a very active campaign to convince both internal and external audiences that ICE can compete effectively in an open market. He recently told the Charg that he meets weekly with union rank and file, by-passing obstinant union leadership, to discuss the changes and opportunities that lie ahead. In addition, he regularly appears in public fora where he pitches the same story. Post expects Quiros to be a very effective witness in the upcoming Asamblea hearings on bills to strengthen ICE and open the telecom market.

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